

RD AN 4223 (1980-E, 4287-B and 4280-B)

October 13, 2006

SUBJECT: Business and Industry Guaranteed and Direct Loan Programs and
Section 9006 Renewable Energy System and Energy Efficiency
Improvements Guaranteed Loan Program – Adequate Consideration

TO: State Directors, Rural Development

ATTN: Business Programs Directors

PURPOSE/INTENDED OUTCOME:

The purpose of this Administrative Notice (AN) is to provide guidance to State Offices concerning when adequate consideration must be received for subordinations, release of collateral, or modification of terms.

COMPARISON WITH PREVIOUS AN:

This AN replaces RD AN No. 4132, dated December 23, 2005.

NATURE OF SERVICING REQUEST:

Adequate consideration must be addressed when responding to a request for (1) the release of collateral or guarantors, (2) the Agency to take a lesser lien position (i.e. subordination); (3) the sale of collateral (e.g. sale of a parcel of land or equipment), etc. This list is not comprehensive. Any action which involves the exchange, subordination, or release of collateral should be evaluated under this AN.

All Section 9006 Renewable Energy Systems and Energy Efficiency Improvements Guaranteed Loans will be serviced in accordance with RD Instruction 4280-B, section 4280.152.

EXPIRATION DATE:

October 31, 2007

FILING INSTRUCTIONS:

Preceding Instructions 1980-E, 4287-B and 4280-B

IMPLEMENTATION RESPONSIBILITIES:

In order to respond to these requests, initially you must determine Rural Development Business Programs' (Business Programs) interest in the collateral.

- a) Owner Interest – Business Programs may have just an owner's interest in the collateral. This could arise when Business Programs is the successful bidder at a foreclosure sale on a Direct Business and Industry (B&I) Loan.
- b) Lender Interest – Business Programs may have just a lender's interest in the collateral. This could arise when Business Programs has an outstanding direct or guaranteed loan (in which it has not repurchased any holder's interest).
- c) Combination Interest – Business Programs may have both an owner's and lender's interest in the collateral. This could arise when Business Programs has repurchased a holder's interest in an outstanding B&I Guaranteed Loan.

Based on your evaluation of Business Programs' interest in the collateral, you should apply the relevant section below.

Owner Interest:

In those cases where the Agency has acquired title to the collateral, the Comptroller General Opinion is applicable.

The Comptroller General Opinion (19 Com Gen 48) states, "Government officers are not authorized to modify the terms of a contract by a supplemental or substitute agreement if such modification is prejudicial to the interest of the United States, nor to give away the money, property, or any claim of the Government."

Therefore, the Agency will not modify its interest in the collateral, including modifying loan covenants, releasing personal or corporate guarantees or other collateral, or subordinating its lien position without receiving new consideration that will adequately secure the loan. (Past consideration does not meet this requirement.) New consideration that will adequately secure the loan encompasses some new benefit to the Agency either in the form of money, additional security, or some other benefit to the goals and objectives of the Agency.

Lender Interest:

Usually the Agency's interest will be that of a lender or guarantor. In those cases, the controlling statute is section 331 of the CONACT which provides the Agency several options. These provisions have been implemented into the following regulations:

Direct Program:

Debt Settlement (7 CFR 1956, subpart C),
Release of Collateral (7 CFR 1951-E, section 1951.226), and
Subordination (7 CFR 1951-E, section 1951.222);

Guaranteed Program:

Release of Collateral (7 CFR, 4287-B, section 4287.113), and
Subordination (7 CFR, 4287-B, section 4287.123).

When the Agency has just a lender's interest in the collateral, whether from the direct or guaranteed programs, then modifications to its interest in the collateral, including the release of collateral, borrowers, or guarantors, or subordinations, must be in accordance with these regulations. These loans should never be under-collateralized at the time a servicing or loanmaking decision is made. Please adequately document your case files whenever making these servicing decisions.

When considering loan servicing actions for guaranteed loans involving subordinations and the release of collateral, you should:

1. Review the regulatory requirements that are set forth in the regulations that are pertinent to the servicing action being considered.
2. Obtain current financial statements on the borrower and guarantors, less than 60 days old and have them reviewed by the lender.
3. Obtain a current independent appraisal on all actions exceeding \$100,000 of collateral. The appraisal will be on all collateral that secures the guaranteed loan in accordance with RD Instruction 4279-B, section 4279.144. You should use this appraisal to document that the remaining collateral is adequate to secure the loan. The borrower must pay for the appraisal.
4. Insure that the collateral position is no less than 1:1 upon completion of the servicing action.

Combination Interest

As previously mentioned, with the guaranteed program there will be occasions when the Agency has both a lender and an owner interest (e.g. the Agency has repurchased the holder's interest in an outstanding loan). In this situation, you must consider the request of lender without regard to Agency's owner interest. There could also be instances in which the Agency's lender and the owner interests are in conflict. In this case, you should forward the request to the National Office using RD Instruction 4287-B, Appendix A with your recommendation for consideration by this office.

If there are questions, please call Specialty Lenders Division at (202) 720-1400 or David Lewis, Chief, Business and Industry Division Servicing Branch at (202) 690-0797.

(William F. Hagy III) for

JACKIE J. GLEASON
Administrator
Business and Cooperative Programs